

# Government Auditing Standards 2003 “Yellow Book” version

Prepared for GMAP Staff  
With a Focus on Performance Audits  
August 2006





# What are Government Auditing Standards?

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- ◆ First issued by the federal General Accounting Office (GAO) in 1972.
  - Also known as “Yellow Book” Standards and Generally Accepted Government Auditing Standards (GAGAS).
- ◆ Applied to audits of federal government organizations, programs, activities, and functions, and government assistance received by contractors, nonprofit organizations, and other nongovernment organizations.
- ◆ Pertain to auditor professional qualifications, quality of audits, and characteristics of professional and meaningful audit reports.



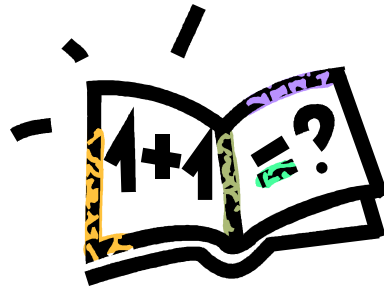
# Why Audit Standards?

- ◆ Accountability
  - Government officials are accountable to the public.
  - Accountability creates higher demand for more information about government programs and services.
  - Standards provide accountability and assist public officials in carrying out their responsibilities.
- ◆ Basic Premises
  - Public officials and employees are responsible for:
    - Efficient, economical, and effective use of resources.
    - Complying with applicable laws and regulations.
    - Establishing and maintaining effective controls.
    - Providing reports to those whom they are accountable.
    - Addressing the findings and recommendations.
    - Following sound procurement and contract monitoring practices.
  - Auditing provides credibility through objective analysis of evidence.



## Related History

- ◆ Prompted by financial fraud scandals, the major financial professional associations formed the Committee of Sponsoring Organizations (COSO) in 1985 to sponsor the National Commission on Fraudulent Financial Reporting.



- ◆ Commonly referred to as the Treadway Commission, this group studied the reasons leading to the fraudulent reporting and in 1987 released recommendations to mitigate those reasons.



# COSO Key Concepts

- ◆ COSO Definition of Internal Control
  - Internal control is a *process*.
  - Internal control is effected by *people*. It is not just policy manuals.
  - Internal control can be expected to provide only *reasonable* - not absolute - *assurance*.
  - Internal control is geared to the achievement of *objectives* in categories including:
    - Effectiveness and efficiency of operations.
    - Reliability of financial reporting.
    - Compliance with applicable laws and regulations.



# Yellow Book Standards Compatibility

- ◆ COSO Key Concepts are understood and accepted by auditors, and complement auditing standards.
- ◆ Yellow Book Standards may be used in conjunction with other professional standards, such as:
  - Generally Accepted Auditing Standards (American Institute of Certified Public Accountants).
  - Institute of Internal Auditors Standards.
  - Internal Organization of Supreme Audit Institutions (INTOSAI) Standards.
- ◆ Entities not specifically covered by the Yellow Book Standards may or may not choose to use them.
  - GAGAS is followed by many state and local public sector entities.





# Auditor Responsibilities

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Auditors are responsible for:

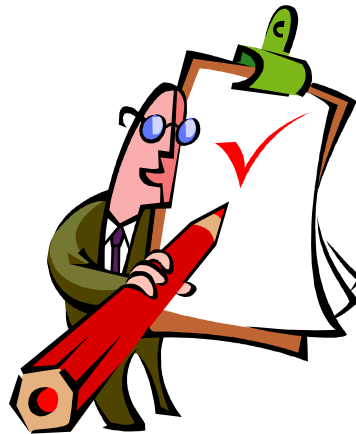
- Acting in a way that serves the public interest, honors public trust, and upholds their professionalism.
- Making decisions consistent with the public interest.
- Performing all professional responsibilities with integrity.
- Being objective and free of conflicts of interest, including maintaining independence in fact and appearance.
- Using professional judgment when establishing scope and methodologies, determining procedures, conducting work, and reporting the results.
- Helping management and report users understand the auditor responsibilities under GAGAS.



# Audit Organization Responsibilities

The audit organization has the responsibility for ensuring that:

- Independence and objectivity are maintained in all phases of the assignment.
- Professional judgment is used in planning and performing the work, and reporting the results.
- Work is performed by personnel who are professionally competent and collectively have the necessary skills and knowledge.
- An independent peer review is periodically performed.





# Major Types of Government Audits

Audit objectives determine the type of audit to be conducted and audit standards to follow:

- ◆ Financial

- Primarily financial statements.



- ◆ Performance

- Program effectiveness and results (e.g., achievement of program objectives or desired results, effectiveness of program or components).
- Economy and efficiency (e.g., adequate management control, appropriate staffing levels, properly protecting resources).
- Internal control (e.g., processes and procedures for planning, organizing, directing, and controlling program operations).
- Prospective focus (e.g., assessing policy alternatives, identifying best practices).

- ◆ Attestation Engagements

- ◆ Nonaudit Services



# General Standards – Independence

Audit organization and individual auditors should be free from impairments to independence, be organizationally independent, and maintain independent attitude and appearance.

## ◆ Personal

- Relationships, biases, previous responsibility for audit area, financial interest.



## ◆ External

- Restrictions to scope, audit procedures, time to complete, assignment of audit personnel, and funding.
- Authority to overrule or influence judgment as to content.

## ◆ Organizational

- Accountable to head of government entity, organizationally located outside staff or line management function of unit being audited.
- Report regularly to independent audit committee or oversight body.
- Merit-based system (i.e., removed from political pressure).



# General Standards – Professional Judgment

Professional judgment should be used in planning and performing audits and in reporting the results.

- ◆ Exercise reasonable care and diligence.
- ◆ Use professional judgment in determining:
  - Type of audit to be performed.
  - Defining scope.
  - Selecting methodology.
  - Determining type and amount of evidence to be gathered.
  - Evaluating and reporting results.
- ◆ Exercise professional skepticism.



# General Standards – Competence

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Staff assigned to the audit should collectively possess adequate professional competence for the tasks required.

## ◆ Staff Qualifications

- Knowledge of GAGAS, and education, skills and experience to apply knowledge to assigned work.
- General knowledge of environment of audited entity and subject matter under review.
- Written and oral communication skills.
- Skills appropriate to audit work being performed.



## ◆ Continuing Education Requirements

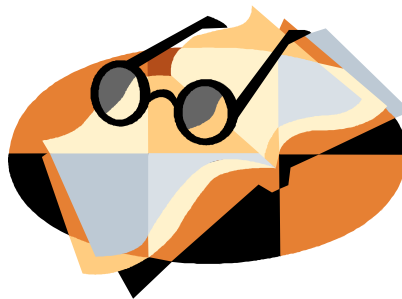
- 80 CPE hours every two years; minimum 20 hours in one year.
- 24 hours directly related to government environment or accounting.
- Audit organizations responsible for assuring CPEs are met.
- External consultants are not subject to the same training requirements, but should maintain professional competence.



# General Standards – Quality Control and Assurance

Audit organizations should have an appropriate internal quality control system and undergo external peer review.

- ◆ Internal quality control system = policies and procedures to provide reasonable assurance of compliance with standards.
- ◆ External peer review should occur once every 3 years.
  - A written report is issued.
  - Audit organizations contracting to work in accordance with GAGAS should provide the report.
  - Government audit organizations should transmit the report to their oversight bodies and make it available to the public.

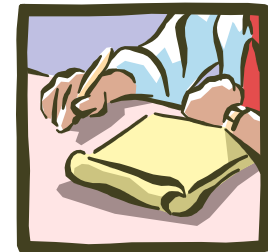




# Fieldwork Standards – Planning

Work is to be adequately planned.

- Define objectives, scope and methodology.
- Consider program significance.
- Obtain an understanding of the program.
- Obtain an understanding of internal control system.
- Design audit to detect violations, fraud, and abuse.
- Identify audit criteria (must be reasonable, attainable, relevant).
- Consider results of previous audits.
- Identify sources of audit evidence.
- Consider work of other auditors.
- Assign appropriate staff and other resources.
- Communicate planning and performance of audit.
- Prepare a written audit plan.



# Field Standards – Supervision

Staff are to be properly supervised.

- Provide sufficient guidance to staff members.
- Keep informed of significant problems encountered.
- Document review of the audit work performed.
- Provide effective on-the-job training.
- The level of supervision needed will vary depending on the experience of the assigned auditor.



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# Fieldwork Standards – Evidence

Auditors need sufficient, competent, relevant evidence to form conclusions and recommendations. Types of evidence include:

- Physical

Preferable

Obtained through direct inspection or observation. Includes photographs, maps, physical samples.

- Documentary

Information such as letters, contracts, accounting records.

- Testimonial

Obtained through interviews, inquiries, questionnaires, surveys.

Should be  
verified by  
other evidence  
if possible

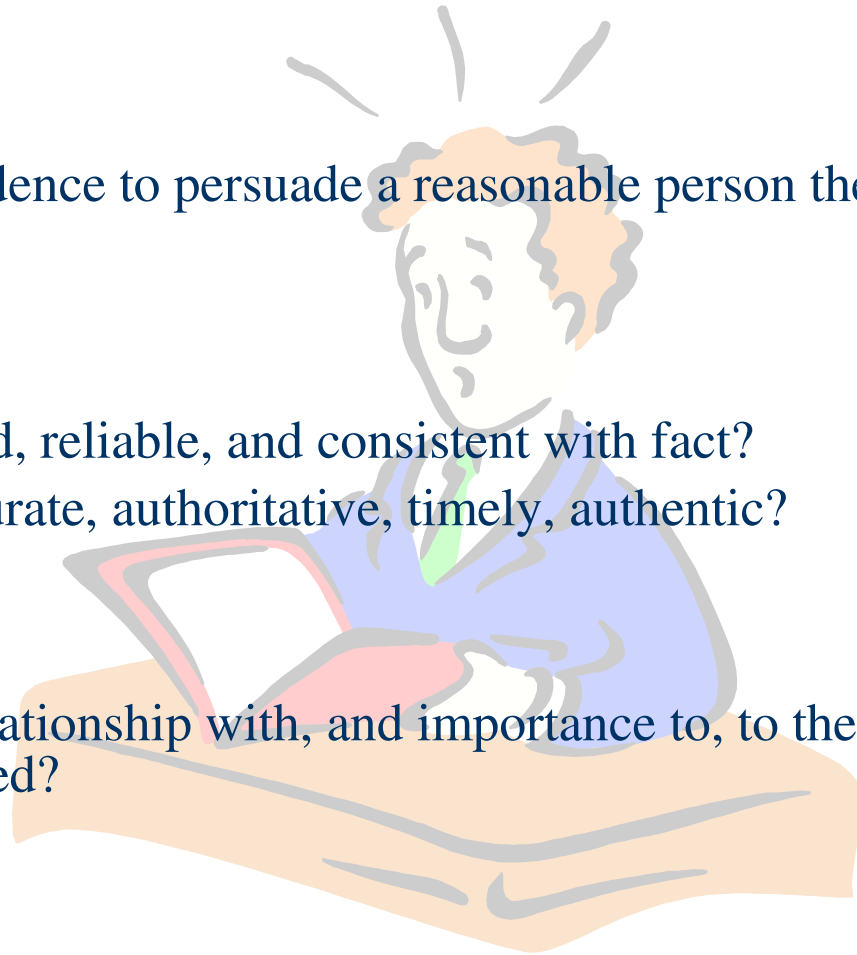
- Analytical

Created by auditor through computations, comparisons.

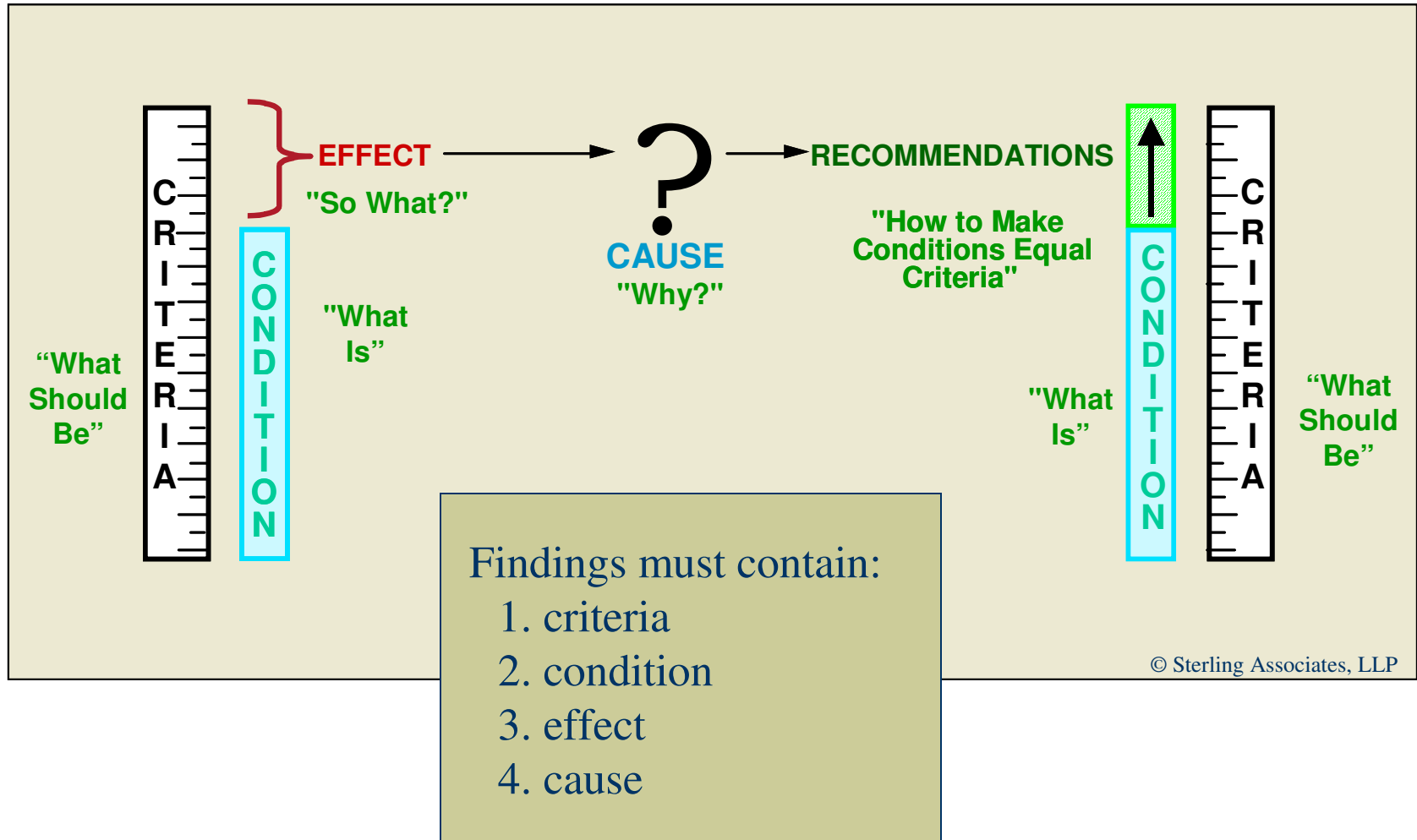


# Fieldwork Standards – Tests of Evidence

- ◆ Evidence should be sufficient, competent, and relevant.
  - Sufficient
    - Is there enough evidence to persuade a reasonable person the findings are valid?
  - Competent
    - Is the evidence valid, reliable, and consistent with fact?
    - Is the evidence accurate, authoritative, timely, authentic?
  - Relevant
    - Is there a logical relationship with, and importance to, to the issue being addressed?



# Fieldwork Standards – Audit Findings





# Fieldwork Standards – Audit Documentation

Auditors should prepare and maintain audit documentation.

- ◆ Audit documentation serves to:
  1. Provide the principal support for the report.
  2. Aid auditors in conducting and supervising the audit.
  3. Allow for the review of audit quality.
- ◆ Audit documentation should contain:
  - Objectives, scope and methodology.
  - Whether certain standards were not applied, and why.
  - Documentation of work performed.
  - Evidence of supervisory review of work performed.
- ◆ Audit documentation should be retained, safeguarded, and shared as appropriate.

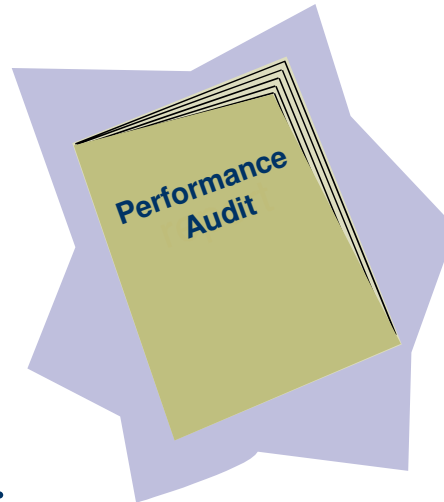




## Reporting Standards – Form

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Auditors should prepare audit reports communicating the results of each audit.



- ◆ These written reports:
  - Communicate audit results to officials at various levels of government.
  - Make the results less susceptible to misunderstanding.
  - Make the results available for public inspection.
  - Facilitate follow-up on whether corrective action has been taken.



# Reporting Standards – Report Contents

- ◆ Objective, scope, and methodology
  - Also important to convey to reader what *wasn't* done.
- ◆ Findings
  - Based on evidence.
- ◆ Internal control deficiencies
  - Control weaknesses may be considered a “cause” of deficient performance.
- ◆ Fraud, Illegal Acts, Violations of Contracts, and Abuse
  - Place finding in perspective for readers (how severe?).
- ◆ Conclusions
  - State clearly – don't leave for readers to infer.
- ◆ Recommendations
  - Should be directed at cause, action-oriented, specific, addressed to parties with authority to act, practical, cost-effective and measurable.



# Reporting Standards – Report Contents

(continued)

- ◆ Statement on compliance with GAGAS
  - If a standard wasn't followed, state why.
- ◆ Views of responsible officials
  - Include copy of written comments received.
  - If comments oppose the audit results or are invalid, the auditor may state their reasons for disagreeing.
  - If comments are valid, auditors should modify the report as necessary.
- ◆ Privileged and confidential information
  - Include nature and reason for any omitted information.
  - Auditors may issue a limited-official-use report for certain information prohibited from general disclosure (e.g., computer security).



# Reporting Standards – Report Quality Elements

Reports should be:

**Timely**

- Respond to needs with relevant, current information.

**Complete**

- Contain all information to satisfy objectives.

**Accurate**

- Correct portrayal of competent, relevant evidence.

**Objective**

- Balanced in content and tone, fair.

**Convincing**

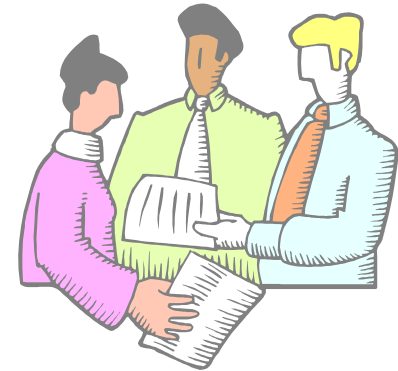
- Responsive to objectives, persuasive.

**Clear and concise**

- Easy to read.

# Reporting Standards – Report Issuance and Distribution

- ◆ Reports should be distributed to the auditee and the officials requesting the audit.
- ◆ Copies of reports should be sent to others with legal oversight authority or responsibility for acting on findings.
- ◆ Copies should be made available for public inspection.



# History of Yellow Book Changes

